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AUTHOR Hickrod, G. Alan; Hubbard, Ben C.
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ABSTRACT

This paper examines the impact of Illinois' present system of state aid to education in light of the rationale for its adoption, and argues that the stated purposes of the present system would be better realized through the adoption of a "two-tiered" finance system. The present Illinois system consists of the Strayer-Haig system of foundation grants and a "resource equalizer" system of aid to districts based on their local tax effort. The authors argue that much of the political support for this system was based on the desire for overall property tax relief, and not on the desire to reduce disparities in per-pupil expenditures between districts. Although Illinois' resource equalizer system did provide short-term tax relief during its phase-in period, they point out, its long-term effect is to reward increases in local tax rates. By adopting a "two-tiered" system, they suggest, it would be possible to provide more or less of this district power equalizing, simply by varying the relative size of the basic foundation grant (tier 1) and the "local initiative" or "tax incentive" grant (tier 2). (Author/JG)

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RETURN TO THE "TWO-TIER" FUNDING NOTION IN ILLINOIS: A Reexamination of the Basic Rationale for the School Finance Reform of 1973

G. Alan Hickrod and Ben C. Hubbard

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Recent actions by the state legislatures in Missouri and in South Dakota suggest that it would be profitable to again explore the "two-tier" funding notion in Illinois.(1) "Two-tier" funding is neither a new concept, nor a new practice in school finance. The state of Utah, for example, practiced such a multiple tier funding system for many years, although that state no longer operates such a system. In Illinois a "three-tiered" system was officially endorsed by a "blue ribbon" citizens commission in 1972. The Finance Task Force of the Governor's Commission on the Schools proposed such a multiple tiered system in December of 1972.(2) The "third tier" of this system, however, was simply to be local revenues, unequalized by the state, so for state grant-in-aid purposes, it was essentially a "two-tiered" system. The major division between the members of the Finance Task Force was over whether the first "tier" should be a simple bloc grant going to every school district, rich or poor, or whether the first tier should be a foundation or Strayer-Haig grant with the second tier added on to the first. As members of that task force in 1972, the authors of this paper took the position that the first tier should be the foundation or Strayer-Haig model. Less than a

month after that report in Illinois, in January of 1973, another national "blue ribbon" group, the Phi Delta Kappa Commission on Alternative Designs for Funding Education, also endorsed the "two-tiered" model as their preferred system of K-12 grants-in-aid.(3) Their alternative #5 was described as: "a foundation system supplemented with equalized local initiative." There has, in fact, been a discussion of so-called "mixed models" in the grant-in-aid literature for quite some time.(4)

Subsequent developments in Illincis of a political and organizational nature have moved us away from the "two-tiered" concept. Most individuals and groups now think in terms of two parallel systems of funding as operating in this state: (1) the older Strayer-Haig system with adjustments as made in 1973, and (2) the "resource equalizer" system as passed in 1973 with amendments in 1976. This "parallelism" is rather awkward and makes for difficult problems of districts switching between the funding systems. The older "foundation" or "Strayer-Haig" part of the allocation system is also complicated in that it contains no less than three calculations: the flat grant, the alternate method, and the regular Strayer-Haig calculation. We think it would be helpful to move away from this "parallelism," and return to the notions contained in Governor Olgilvie's Finance Task Force Report of 1972. The purpose of this brief paper is therefore to encourage efforts in that direction from the Illinois Office of Education, the Illinois School Problems Commission, and the many individuals and groups who are now

active in Illinois school finance reform.

To start this process, let us again review the basic algebra that is present in the two-tier approach. The first formula below gives the "basic" grant, and the second formula gives the "tax incentive" grant. With some variations, systems like this are now used in Maine, Montana, Georgia, Missouri, and South Dakota. Some of these states, however, have not implemented both tiers of the approach.

A. Basic Grant:

$$G = FP - rV_i$$

where:

- F = foundation level per pupil or per weighted pupil
- P = pupil count (often weighted)
- r = required tax rate or "charge back"
- V_i = assessed valuation per pupil or weighted pupil in the district

B. Tax Incentive Grant:

$$G = P\left[R\ (V_g - V_i)\right]$$

where:

- R = the difference between the actual tax rate and the required tax rate in the basic grant formula
- V_g = a guaranteed valuation per pupil set by the state
- V_i = the valuation per pupil in the districts
- P = pupil count (often weighted)

Although certain state courts, especially those in Connecticut and New Jersey, have not been sympathetic to flat grants, we

suspect that a third grant would have to be added to the above system in Illinois, e.g., a flat grant for those that are too wealthy to qualify for either the "basic" grant or for the "tax incentive" grant. The real problems here are not with the basic algebra, but rather in the setting of the important constants: F, r, and V_g. For example, it is not unlikely that F would now need to be set in Illinois at near $1,000 per pupil for unit districts. The setting of the constants is a matter for empirical investigation, subject to the usual political considerations, and subject also to the amount of state aid available for the general purpose grant-in-aid formula. It is possible, however, to make some conceptual changes with only a small amount of additional state dollars.

Labeling the second tier a "tax incentive" grant will call attention to the important fact that the present grant-in-aid system in Illinois not only rewards for past and current high local tax rates, it also rewards for <u>increases</u> in local tax rates. In recent reports of this Center we have stressed the fact that there are two quite distinct and separate effects of the "resource equalizer," as the 1973 school finance reform is locally known.(5) The first effect, which we have called the "static" effect, provides larger amounts of state aid to those districts that have high tax rates at the time in which the reform was passed, and, in fact, during the entire period in which the new reform was being "phased in." For most school districts in Illinois that phasing-in period proved to be a

good five years, and for some school districts more than five years. During this "static" period there was little need to raise local tax rates since the increases in state aid received by the districts, payments in effect for past and current effort, were enough in most cases to partially offset the onslaught of inflation on school costs. To be sure, districts that did not receive increases of state aid under the 1973 reform had to meet the effects of inflation solely from the local tax side. Looked at in this perspective a major consequence of the 1973 reform in Illinois was to dampen down local tax rate increases which might have occurred during the "phase-in" period had the reform not been passed. In data not yet published by this Center we have some proof of this speculation in that the average operating tax rate increase for Illinois school districts after the 1973 reform is considerably lower than the average operating tax rate increase before the reform.

This "static" effect is, in reality, a tax relief phenomenon, at least in the sense of lowering the rate of local tax increase, but not actually lowering the absolute level of local taxes. It might also be thought of as a "substitution" in that what taxpayers apparently did was to substitute increases in state aid for increases that would have had to have been forthcoming from the local revenue side. Probably this substitution was only partial since total state and local revenues did increase during the phase-in period. Much of this has to be speculation since we know so little about the actual

behavior of taxpayers in school districts, especially that behavior under "reward for effort" grant-in-aid systems. It is interesting to remember at this juncture that a good many votes in the General Assembly and much of the support from the Governor's office in 1973 concerning the "resource equalizer" came not from the desire to reduce the disparity between expenditures per pupil between school districts, but rather from the desire to provide property tax relief to taxpayers. In the "static" period, it seems those votes and that support were especially well informed since the taxpayer did get a respite from increasing local tax rates. That relief, however, was based upon reward for past and current high tax rates, and not upon reward for increases in tax rates.

The "dynamic" effect is very, very different, and this sets in once the formula is fully funded and the constants in the formula are not changed for at least a few years. The "dynamic" effect on the districts depends really on a "static" formula. In this post "phase-in" period the only way a school district can increase its state aid is by increasing its local tax rate, assuming that: (1) it does not gain students, (2) it does not lose property valuations, and (3) it does not gain title one eligibles and/or its percentage of title one eligibles does not change. By no stretch of the imagination can the "resource equalizer" be thought of as "tax relief" in the "dynamic" sense. To the contrary, should a district actually lower its local tax rate to give relief to the citizens it will

be penalized by the state for so doing, since that action will register as lower effort in the "reward for effort" formula, and, all other things remaining constant, the district will receive less state aid. We have received sporadic information concerning districts which reduced their local tax rate due to increases in property valuations, usually caused by the effect of inflation on farm land or an occasional area where the assessment process caused assessments to increase rapidly. These districts were then surprised to find that the state accordingly reduced the amount of state aid they received since they were no longer exerting as much "fiscal effort." If this action was planned and expected, we would not be so concerned. However, the surprise registered by at least some school boards, and some local educational administrators, is indicative of the fact that neither apparently understands the basic rationale of a school finance reform that is now in its fifth year! Which is one of the reasons for this paper. Both the legislators and the school boards must understand that what we have at this moment is a system that rewards only those districts that show local initiative by passing referenda and by increasing their operating tax rates. Districts which cannot pass referenda will be doubly penalized. They will lose the local revenues, which of course they would under any joint state-local funding system, but under any DPE system including the "resource equalizer" they will also lose, or more correctly, "lose out" on increases in state aid. As we have often

said, district power equalization, or the "resource equalizer" is "local control with a vengeance." Or as Professor Hubbard once called it, a "particularly painful panacea." The important fact that we think has now been lost sight of is that the reform of 1973 was a "local initiative" reform. Its long-run effects, as opposed to its short-run effects, will be to reward those districts that tax more for education and to penalize those districts that tax less for education. Presumably most "schoolmen" would support at least some "local initiative," since they are interested in increasing the total state-local pool of funds for K-12 education.

If the reform of 1973 is ever fully understood we believe the debate will focus on just how much "reward for effort" or how much "local initiative" one really wants in a school finance system. Fortunately that kind of debate can be easily handled within the conceptual framework we are stressing in this paper, e.g., the "two-tier" approach. We can expect two schools of thought to form, if in fact they do not already exist. One school of thought will argue that we have too much "reward for effort" now in the Illinois system. This school of thought will be concerned with those school districts that cannot, or perhaps more correctly, will not, pass operating tax referenda, and hence will, in the long run, be left behind school districts that are willing to show local initiative by raising the local tax rates. This school of thought will also make much of the fact that property taxes are a most unpopular

form of taxation and that about the last thing the state needs is a system that stimulates, at least in the long run, increases in local property tax rates. This school of thought will champion a high foundation level (tier one) with a small amount of local initiative or tax incentive (tier two). The second school of thought will want a modest foundation level (tier one) with a considerably greater district power equalization (tier two). This school of thought will argue for the continuation of at least 50 percent funding from the local level, and probably bring out all the older arguments for local control of educational funding in the process. They can also be expected to cite all the dangers of moving to a state income tax base and a state sales tax base as the primary support for K-12 education, which is what will happen when state support in Illinois exceeds 50 percent of the total funding. There are other arguments, and we have only touched the surface of this debate over the "proper" mixture of the two tiers of funding.

There are also all sorts of complications in making the "two-tier" system operational for Illinois. The old Illinois complication of having three kinds of school districts--units, elementaries, and high schools--will again rear its ugly head and we shall probably have to have not one, but three "two-tier" models. The wars between the duals and the units, which at times approach the intensity and fervor of the "religious wars" of the late Middle Ages in Europe, will break out all over again. The matter of incentives for reorganization and

consolidation will again enter the picture and the small school districts will again take up their continuing crusade against the infidels who do not believe in the benefits of small town life. We can also expect certain regions of the state to favor one tier more than the other tier, just as certain regions of the state and certain kinds of school districts now support the "resource equalizer" more than the "Strayer-Haig." However, this is all part of the "kitchen" of Illinois school finance in which there is always considerable "heat."

There is an old Chinese saying that "he who rides the tiger may not get off to rest." The "resource equalizer" is much that kind of situation. If the constants in the formula are <u>not</u> raised then the system will automatically become an incentive to raise local tax rates. This can be avoided, at least for a time, by increasing the state's reward for effort for the <u>present</u> tax rates. One could do this by simply increasing the guaranteed valuation constant in the present "resource equalizer" formula. Presumably what would then happen would be what happened during the "phase-in" period, e.g., the local taxpayers would again avoid the necessity of raising local property taxes by substituting this new influx of state aid. But this medicine could well kill the patient since by raising the guaranteed valuation one also guarantees a greater state aid reward for each new cent of tax rate added to the old tax rate. The defenders of a high second tier, e.g., a strong "resource equalizer" element in the present formula, must

accept the fact that they want to maintain high local property tax rates for education and therefore keep a good deal of local money in the joint state-local system. This is a perfectly defensible point of view, and it has a good deal of tradition and history behind it, but they cannot expect everyone to agree. The "two-tier" approach is by no means the only solution to Illinois school finance problems, but it is certainly worth a reexamination.

To be sure, there are many other important considerations in the Illinois grant-in-aid formula that need development: the effect of inflation on the constants (of any formula), the measurement of "effort" in any incentive portion of a formula, the measurement of "ability to pay" in any formula, possible use of a geographic cost of living index, possible use of a local option income tax, effect of the new farm valuation law, effect of fractional assessments, etc.(6) However, while these developments must go forward, we should not overlook the possibility of tightening up the basic conceptual framework of the grant-in-aid system. Since the Education Finance Center of the Education Commission of the States has successfully advanced the notion of a foundation level supplemented with a guaranteed tax base add-on in Missouri and South Dakota it would seem appropriate to invite Dr. Allan Odden and perhaps some of his staff to look at such a possibility in Illinois.(7) As always, the authors of this paper stand ready to assist anyone, or any group, in school finance reform efforts in Illinois.

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